

**NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2003**

NOTE 4 – DEPOSITS WITH FINANCIAL INSTITUTIONS, INVESTMENTS, AND REVERSE REPURCHASE AGREEMENTS

Deposits

The County maintains deposit relationships with several local commercial banks and thrift institutions in addition to its concentration bank.

All deposits not covered by the Federal Depositary Insurance Corporation (FDIC) are covered by the Public Deposit Protection Commission of the State of Washington (PDPC). The PDPC is a statutory authority established under chapter 39.58 RCW. It constitutes a multiple financial institution collateral pool that can make *pro rata* assessments to all public depositaries within the state of up to 10 percent of all their public deposits. There is no current provision for PDPC to make additional *pro rata* assessments if needed to cover a loss. Therefore, in accordance with GASB, *Codification of Governmental Accounting and Financial Reporting Standards*, Section 150.110, PDPC protection is of the nature of collateral, not of insurance. As of December 31, 2003, the carrying amount of deposits for the Primary Government was \$459,568,239 and the bank balance was \$441,895,438.

| | Carrying Amount | Bank Balance | Category 1 | Category 2 | Category 3 |
|-------------------------|----------------------------|-------------------------|-----------------------|-------------------|----------------------|
| Demand deposits | \$ 41,295,478 | \$ 23,622,677 | \$ 21,378,796 | \$ - | \$ 2,243,881 |
| Certificates of deposit | 418,272,761 | 418,272,761 | 338,162,677 | - | 80,110,084 |
| Total deposits | <u>\$ 459,568,239</u> | <u>\$ 441,895,438</u> | <u>\$ 359,541,473</u> | <u>\$ -0-</u> | <u>\$ 82,353,965</u> |

Category 1 includes: (1) deposits insured by the FDIC (insured up to \$100,000 per bank); and (2) a proportionate share of deposits uninsured but collateralized under the PDPC multiple financial institution collateral pool. Pledged securities under the PDPC collateral pool are held by the County's agent in the name of the County. Some large depositaries hold public deposits in amounts in excess of the market value of the entire PDPC collateral pool. To the extent that uninsured public deposits of a financial institution exceed the PDPC's total pool value, equivalent proportions of the County's deposits in those institutions are classified as Category 3. Determination of these amounts is based on the conservative assumption that none of the excess public deposits were covered by FDIC insurance. Although such risk is recognized, the PDPC provides additional protection by maintaining strict standards as to the amount of public deposits financial institutions can accept, and by monitoring the financial condition of all public depositaries and optimizing collateralization requirements. There are no uninsured deposits which are collateralized by securities held by the County's agent but not in the County's name (Category 2).

Investments

Statutes authorize King County to invest in obligations of the United States Treasury and instrumentalities, banker's acceptances issued in the secondary market, commercial paper, primary certificates of deposit issued by Washington State qualified public depositaries as defined under chapter 39.58 RCW, and the State Treasurer's Investment Pool. The County is also authorized to enter into repurchase and reverse repurchase agreements.

County investment policies require that securities underlying repurchase agreements must have a market value of at least 102 percent of the cost of the repurchase agreement for investment terms of less than 30 days, and 105 percent for terms longer than 30 days. Repurchase

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agreements in excess of 60 days and reverse repurchase agreements exceeding 180 days are not allowed. Currently, the County's tri-party custodial bank monitors compliance with these provisions. The County does not enter into yield maintenance repurchase agreements. The County operates under the GASB's *Codification*, Section 2300.601, definition of derivatives and similar transactions. During the year, the County did not buy, sell, or hold any derivative or similar instrument except for certain US agency mortgage-backed securities purchased by the King County Investment Pool to enhance investment yield. Although these securities are sensitive to early prepayments by mortgagees, usually resulting from a decline in interest rates, county policies are in place to ensure that only the lowest risk securities of this type are acquired.

The County's investments are categorized to give an indication of the level of credit risk assumed at year-end. Category 1 includes investments that are insured or registered, or for which the securities are held by the County or its agent in the County's name.

The schedule below shows the types of investments made during the year and the investment values at the end of the year for the Primary Government. These exclude the equity in the component units. All investments are reported at fair value. Fair value pricing is provided by the County's safekeeping bank or an independent pricing source.

| | Category 1 | Category 2 & 3 | Carrying Amount (Fair Value) |
|---|-------------------------|-------------------|------------------------------------|
| Repurchase agreements | \$ 226,494,556 | \$ - | \$ 226,494,556 |
| Commercial paper | 793,447,391 | - | 793,447,391 |
| Municipal bonds | 141,571,448 | - | 141,571,448 |
| Mortgage-backed securities | 402,603,994 | - | 402,603,994 |
| US government securities: | | | |
| Treasury notes | 26,205,394 | - | 26,205,394 |
| US agency issues | 1,083,412,773 | - | 1,083,412,773 |
| Totals | <u>\$ 2,673,735,556</u> | <u>\$ -</u> | <u>2,673,735,556</u> |
| Investments under reverse repurchase agreements | | | |
| Treasury Securities | | | 144,685,129 |
| State Treasurer's Investment Pool | | | 82,136,179 |
| Total Investments (Primary Government) | | | <u>\$ 2,900,556,864</u> |

There were no losses incurred during the period as a result of default by counterparties to deposit or investment transactions. During the period, there were no known violations of legal or contractual provisions for deposits and investments.

Reverse Repurchase Agreements

Statutes permit King County to enter into reverse repurchase agreements, that is, a sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. County policy prohibits the use of these agreements as a borrowing mechanism. The proceeds from these agreements are reinvested in other instruments with the same maturities as the collateral securities, resulting in a matched position.

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The assets and liabilities related to the Investment Pool-owned reverse repurchase agreements were allocated to the individual pool participants based on their equity in the pool as of December 31, 2003. The liability is reported as obligations under reverse repurchase agreements and the assets are reflected as an increase in cash equivalents in the balance sheets of funds that participate in the internal portion of the Investment Pool and in the Investment Trust Funds "Combining Statement of Net Assets" for funds that participate in the external portion of the Investment Pool.

Reverse repurchase agreements are subject to credit risk. Should the dealers default on their obligation to resell these securities to the County, the County would be faced with an economic loss equal to the difference between the market value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest. The credit exposure at year-end was \$1,107,670 on reverse repurchase agreements in the Investment Pool.

External Investment Pool

For investment purposes, the County pools the cash balances of county funds and component units and also allows for participation by other legally separate entities such as special districts, for which the County is *ex officio* treasurer, and public authorities. The King County Investment Pool (the Pool) is an external investment pool. The external portion of the Pool (portion that belongs to special districts and public authorities other than component units) is reported in an Investment Trust Fund. It is county policy to invest all county funds in the Pool. All non-County participation in the Pool is voluntary.

The Pool is not registered with the SEC as an investment company. Oversight is provided by the King County Executive Finance Committee (EFC) pursuant to RCW 36.29.020. The EFC consists of the Chair of the County Council, the County Executive, the Chief Budget Officer, and Director of the Finance and Business Operations Division. All investments are subject to written policies and procedures adopted by the EFC. The EFC reviews pool performance monthly.

Summary information for all pool investments as of December 31, 2003, is presented below:

| <u>Investment</u> | <u>Fair Value</u> | <u>Principal</u> | <u>Average Interest Rate</u> | <u>Average Years To Maturity</u> |
|---|--------------------------|-------------------------|-------------------------------------|---|
| Certificates of deposit & saving accounts | \$ 399,285,759 | \$ 399,285,759 | 1.44% | 0.47 |
| Repurchase agreements | 234,842,000 | 234,842,000 | 1.00 | 0.02 |
| Commercial paper | 822,689,849 | 824,145,000 | 1.17 | 0.17 |
| Municipal bonds | 146,789,056 | 154,010,000 | 3.70 | 2.61 |
| US government securities: | | | | |
| Treasury securities | 174,805,000 | 175,000,000 | 1.66 | 1.98 |
| Agency securities | 1,121,211,002 | 1,104,950,000 | 3.26 | 1.34 |
| Agency mortgage-backed securities | 417,268,063 | 409,028,611 | 4.78 | 2.07 |
| State Treasurer's Investment Pool | 85,163,303 | 85,163,303 | 1.07 | 0.14 |
| Totals | <u>\$ 3,402,054,032</u> | <u>\$ 3,386,424,673</u> | <u>2.45%</u> | <u>1.01</u> |

The Pool values participants' shares using an amortized cost basis. Monthly income is distributed to participants based on their relative participation during the period. Income is calculated based on: (1) realized investment gains and losses calculated on an amortized cost basis; (2) interest income based on stated rates (both paid and accrued); and (3) the amortization of discounts and premiums on a straight-line basis. Income is reduced by the contractually agreed

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upon investment fee. This method differs from the fair value method used to value investments in this statement because the amortized cost method is not designed to distribute to participants all unrealized gains and losses in the fair values. The total difference between fair values of the investments in the Pool and the values distributed to the Pool participants using the amortized cost method described above is reported in the equity section of the statement of net assets as undistributed and unrealized gains.

All securities are reported at fair value. Fair value reports are prepared monthly and are distributed to all Pool participants. Fair value pricing is provided by the County's security safekeeping bank. If a security is not priced by the County's safekeeping bank, prices are obtained from Bloomberg L.P., a provider of fixed income analytics, market monitors, and security pricing. The County has not provided or obtained any legally binding guarantees to support the value of the Investment Pool's shares.

Custodial Risk

The Pool's deposits and investments are classified in various categories of custodial risk based on the same criteria for all deposits and investments of the County.

Deposits consist of \$399,285,759 in certificates of deposit (CDs) and savings accounts, of which \$343,105,347 is category 1 and \$56,180,412 is category 3.

As of December 31, 2003, investments other than CDs that are in the Pool are categorized into risk categories as follows:

| | Category 1 | Category 2 & 3 | Carrying Amount (Fair Value) |
|---|-------------------------|-------------------------------|---|
| Repurchase agreements | \$ 234,842,000 | \$ - | \$ 234,842,000 |
| Commercial paper | 822,689,849 | - | 822,689,849 |
| Municipal bonds | 146,789,056 | - | 146,789,056 |
| US government securities: | | | |
| Treasury notes | 24,867,500 | - | 24,867,500 |
| Mortgage-backed securities | 417,268,063 | - | 417,268,063 |
| US agency issues | 1,121,211,002 | - | 1,121,211,002 |
| Totals | <u>\$ 2,767,667,470</u> | <u>\$ -0-</u> | <u>2,767,667,470</u> |
| Investments under reverse repurchase agreements | | | |
| Treasury Notes | | | 150,017,491 |
| State Treasurer's Investment Pool | | | 85,163,303 |
| Total Investments (Total Pool) | | | <u><u>\$ 3,002,848,264</u></u> |

The County's voluntary investment in the Washington State Treasurer's Local Government Investment Pool (LGIP) is not categorized because it is not evidenced by securities in physical or book entry form. The amount is carried at cost which approximates fair value. The LGIP is a 2a7-like pool that is overseen by the Office of the State Treasurer, the State Finance Committee, the Local Government Investment Pool Advisory Committee, and the Washington State Auditor's Office. The LGIP also contracts for an annual outside independent audit.

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As previously indicated, the Pool owns reverse repurchase agreements at December 31, 2003. The investments under reverse repurchase agreements in the above schedule represent the collateral securities transferred to the lender in exchange for the cash received and used to purchase other securities. These securities are also not categorized because they are held by the lender as collateral.

The following is a condensed statement of net assets and changes in net assets for the entire King County Investment Pool as of December 31, 2003:

| <u>Condensed Statement of Net Assets</u> | |
|---|-------------------------|
| Assets | \$ 3,411,324,455 |
| Less: Liabilities | (154,810,683) |
| Net assets held in trust for pool participants | <u>\$ 3,256,513,772</u> |
| Equity of internal pool participants | \$ 1,324,983,492 |
| Equity of external pool participants | 1,931,530,280 |
| Total equity | <u>\$ 3,256,513,772</u> |

| <u>Condensed Statement of Changes in Net Assets</u> | |
|--|-------------------------|
| Net assets at January 1, 2003 | \$ 3,269,873,099 |
| Net change in investments by pool participants | (13,359,327) |
| Net assets at December 31, 2003 | <u>\$ 3,256,513,772</u> |

Individual Investment Accounts

King County also purchases individual investments for other legally separate entities, such as special districts and public authorities that are not part of the financial reporting entity. Net assets in these individual investment accounts are reported in a separate Investment Trust Fund in the Fiduciary Funds section. At year-end, net assets in the individual investment accounts decreased by \$45.6 million (91 percent) as four more special districts transferred from individual investment accounts to the Pool.

Component Units

Harborview Medical Center (HMC)

Harborview Medical Center (HMC) participates in the County's investment pool. HMC's equity in the pool (reported as cash equivalents at June 30, 2003) amounted to \$106,630,635. In addition, HMC maintains demand deposit accounts in various banks. Demand deposits (insured up to \$100,000 per bank) total \$2,197,830 with a carrying amount of \$1,886,365. Deposits and investments for the HMC component unit are categorized according to levels of custodial risk using the same criteria as the categorization for the King County Investment Pool deposits and investments.

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| | <u>Carrying Amount</u> | <u>Bank Balance</u> | <u>Category 1</u> | <u>Category 2</u> | <u>Category 3</u> |
|---------------------------|----------------------------|-------------------------|-----------------------|-------------------|---------------------|
| Equity in Investment Pool | \$ 108,638,948 | \$ 106,630,635 | \$ 104,871,230 | \$ - | \$ 1,759,405 |
| Cash in other banks | 1,886,365 | 2,197,830 | 1,939,875 | - | 257,955 |
| Totals | <u>\$ 110,525,313</u> | <u>\$ 108,828,465</u> | <u>\$ 106,811,105</u> | <u>\$ -0-</u> | <u>\$ 2,017,360</u> |

Washington State Major League Baseball Stadium Public Facilities District (PFD)

The Washington State Major League Baseball Stadium Public Facilities District (PFD) participates in the County's investment pool. The PFD's equity in the pool (reported as cash equivalents at December 31, 2003) amounted to \$18,094,594. Deposits and investments for the PFD component unit are categorized according to levels of custodial risk using the same criteria as the categorization for the King County investment pool. In addition, PFD maintains demand deposit accounts in various banks. Demand deposits (insured up to \$100,000 per bank) total \$785,597 with a carrying amount of \$785,597.

| | <u>Carrying Amount</u> | <u>Bank Balance</u> | <u>Category 1</u> | <u>Category 2</u> | <u>Category 3</u> |
|---------------------------|----------------------------|-------------------------|----------------------|-------------------|-------------------|
| Equity in Investment Pool | \$ 18,093,587 | \$ 18,094,594 | \$ 17,796,033 | \$ - | \$ 298,561 |
| Cash in other banks | 785,597 | 785,597 | 785,597 | - | - |
| Totals | <u>\$ 18,879,184</u> | <u>\$ 18,880,191</u> | <u>\$ 18,581,630</u> | <u>\$ -0-</u> | <u>\$ 298,561</u> |

Cultural Development Authority of King County (CDA)

The Cultural Development Authority of King County (CDA), formerly the Office of Cultural Resources, a King County agency, does not participate in the County's investment pool.